89-128

Supreme Court, U.S.
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No. _____

IN THE SUPREME COURT OF THE UNITED STATES
October Term 1989

John A. Northen, Trustee in Bankruptcy
for Gordon Foods, Inc.
Petitioner

v.

Quinn Wholesale, Inc.
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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July 21, 1989

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QUESTION PRESENTED

11 U.S.C. Section 549(a)(1) of the Bankruptcy Code empowers the trustee in bankruptcy to avoid a transfer of property of the estate made after the commencement of the bankruptcy case. The question presented is: (1) Does the transfer upon payment by check occur at the date the check is tendered (prior to commencement of the case) or at the date the check is accepted and paid by the drawee bank (after commencement of the case) in accordance with applicable state law and the decision of this Court in Bank of Marin v. England, 385 U.S. 99 (1966).

LIST OF PARTIES

The parties to the proceedings below were the petitioner, John A. Northen, trustee in bankruptcy for Gordon Foods, Inc., and the respondent, Quinn Wholesale, Inc.

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IN THE SUPREME COURT OF THE UNITED STATES
October Term, 1989

John A. Northen, trustee in bankruptcy for
Gordon Foods, Inc.,

Petitioner

v.

Quinn Wholesale, Inc.,

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

The petitioner John A. Northen, trustee in bankruptcy for Gordon Foods, Inc., respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fourth Circuit, entered in this proceeding on April 26, 1989.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fourth Circuit is reported at 873 F.2d 77 (1989) and is reprinted in the appendix hereto, p. 1a, infra.

The order and memorandum opinion of the United States District Court for the Middle District of North Carolina (Bullock, F.W.) is not reported but is reprinted in the appendix hereto, p. 5a, infra.

The order and judgment and memorandum opinion of the Bankruptcy Court for the United States District Court for the Middle District of North Carolina were not reported. They are reprinted in the appendix hereto, p. 17a and 19a, respectively.

JURISDICTION

Invoking federal jurisdiction pursuant to 28 U.S.C. 1334(b) and 28 U.S.C. 157(a) and (b), petitioner brought this suit as an adversary proceeding in the Bankruptcy Court of the United States District Court of the Middle District of North Carolina on December 3, 1987. On March 7, 1988 the Bankruptcy Court entered its order and judgment, granting petitioner's motion for summary judgment and denying respondent's cross-motion for summary judgment. See p. 17a, infra. Upon respondent's appeal, the Bankruptcy Court entered a memorandum opinion on April 18, 1988. See 19a, infra.

Upon respondent's appeal pursuant to 28 U.S.C. Section 158, the District Court entered on August 23, 1988 an order and memorandum opinion reversing the order and judgment of the Bankruptcy Court and remanding the case for entry of judgment for respondent. See p. 5a, infra.

On petitioner's appeal, the Fourth Circuit on April 26, 1989 entered a judgment and opinion affirming the District Court's order. See p. 1a, infra. No petition for rehearing was sought.

The jurisdiction of this Court to review the judgment of the Fourth Circuit is invoked under 28 U.S.C. Section 1254(1).

STATUTES INVOLVED

United States Code, Title 11:

§101. Definitions. In this title –

(50) "transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption;

United States Code, Title 11:

§549. Postpetition transactions.

(a) Except as provided in subsections (b) or (c) of this section, the trustee may avoid a transfer of property of the estate –

(1) made after the commencement of the case; and

(2)(A) that is authorized only under section 303(f) or 542(c) of this title; or

(B) that is not authorized under this title or by the court.

(b) In an involuntary case, a transfer made after the commencement of such case but before the order for relief to the extent value, including services, but not including satisfaction or securing of a debt that arose before the commencement of the case in exchange for such transfer, notwithstanding any notice or knowledge of the case that the transferee has.

(c) The trustee may not avoid under subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of the case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so perfected that a bona

fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.

(d) An action or proceeding under this section may not be commenced after the earlier of–

(1) two years after the date of the transfer sought to be avoided; or

(2) the time the case is closed or dismissed.

STATEMENT OF CASE

Gordon Foods, Inc. ("Debtor") was a corporation organized under the laws of North Carolina which operated a retail grocery business in Sanford and Lumberton, North Carolina. On December 5, 1986, Debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Middle District of North Carolina. On March 9, 1987, Debtor's bankruptcy case was converted to a case under Chapter 7 of the Bankruptcy Code and John A. Northen was appointed trustee in bankruptcy for Debtor. During the relevant time period, respondent Quinn Wholesale, Inc. ("Quinn") was a corporation organized under the laws of North Carolina and engaged in the business of wholesale supply of grocery and supermarket inventories. On a weekly basis, Quinn supplied Debtor with inventory and received payment from Debtor for the prior week's delivery of inventory.

On December 4, 1986, Quinn delivered inventory to Debtor, at which time Debtor tendered to Quinn a check

payable to Quinn in the amount of $72,444.62. This check was made in payment for a prepetition debt, the delivery by Quinn of inventory to Debtor the week prior to December 4, 1986. Debtor's check to Quinn was accepted and paid by Debtor's bank on December 9, 1986, four (4) days after the filing of Debtor's voluntary bankruptcy petition on December 5, 1986.

REASONS FOR GRANTING THE WRIT

(1) THE DECISION OF THE FOURTH CIRCUIT CONFLICTS WITH DECISIONS OF THIS COURT REQUIRING CONSTRUCTION OF THE BANKRUPTCY CODE BY REFERENCE TO STATE LAW.

Under established North Carolina statutory and case law, the "transfer" at issue, a check tendered prepetition and accepted and paid by Debtor's bank postpetition, constitutes an assignment or transfer upon the date of payment by the bank. See N.C.G.S. Section 25-3-409; Perry v. Bank of Smithfield, 131 N.C. 117, 42 S.E. 551 (1902); In re Will of Winborne, 231 N.C. 463, 57 S.E.2d 795 (1958).

Adopting the reasoning of the District Court memorandum opinion, the Fourth Circuit opinion below specifically affirmed the conclusion that a "transfer" under 11 U.S.C. Section 549 is controlled by construction of substantive federal law due to the need for uniformity, regardless of conflicts with state law. The District Court interpreted the payment by check to be a "transfer" at the time of tender, basing this construction upon equitable considerations and the legislative history of a distinct section of the Bankruptcy Code, 11 U.S.C. Section 547.

The decision of the Fourth Circuit conflicts in principle with Bank of Marin v. England, 385 U.S. 99 (1966) (applying section 70(d)(5) of the Bankruptcy Act, predecessor to Section 549 of the Code). In Bank of Marin, this Court expressly approved the recovery against the payee of a check under the circumstances of the case sub judice.

> The force of Section 70(d)(5)... can be maintained by imposing liability on the payee.... The payee is a creditor of the bankrupt, and to make him reimburse the trustee is only to deprive him of preferential treatment and to restore him to the category of a general creditor. To permit the trustee under these circumstances to obtain recovery only against the creditor that benefited from the transaction is to do equity.

Id., 385 U.S., at 103.

In dissent from the majority's release of the drawee bank, which transferred funds on deposit upon presentment of the check, Justice Harlan stated that the date of a challenged transfer must be established by reference to state law, as concluded by the Bankruptcy Court in this case.

> I do not understand petitioner to contend, or the Court to suggest, that this [transfer] occurred at a time other than presentment of the checks.... Given the law of California, by which a check is not a pro tanto transfer of the drawer's rights until presentment, I cannot see that another moment is possible. (Parens added).

Id., 385 U.S., at 104.

The concepts of bankruptcy law established in Bank of Marin conflict squarely with the decision below. These concepts are not abrogated by the adoption of the Code. Pre-Code case law such as Bank of Marin is not deemed to have been altered by adoption of the Code absent evidence that Congress intended a change in the law. See Midlantic National Bank v. New Jersey Department of Environmental Protection, 474 U.S. 494 (1986); Kelly v. Robinson, 479 U.S. 36 (1986).

There is no evidence in the legislative history of 11 U.S.C. Section 549 (avoidance of postpetition transfer) or 11 U.S.C. 101 (50) (definition of "transfer") that the judicial concepts enunciated in Bank of Marin were intended to be abandoned under the Code. To the contrary, the legislative history of section 542(c) of the Code expressly affirms Bank of Marin. See Senate Report No. 95-989, 95th Cong., 2d Sess. 84 (1978) ("this subsection codifies the result of Bank of Marin v. England, 385 U.S. 99 (1966)....").

The decision below conflicts with the established precedent of this Court that the rights of parties to a bankruptcy proceeding are "created by and defined by state law." Butner v. United States, 440 U.S. 48, 54-55 (1979). See also Ohio v. Kovacs, 469 U.S. 274, 285-286 (1985) ("the classification of Ohio's interest as either a lien on the property itself, a perfected security interest, or merely an unsecured claim depends on Ohio law") (O'Connor, J., concurring); Board of Trade v. Johnson, 264 U.S. 1, 15 (1974) (trustee assumes rights of debtor under state law at commencement of case).

This conflict justifies the grant of certiorari to review the judgment below.

2. THE DECISION OF THE FOURTH CIRCUIT RAISES SIGNIFICANT AND RECURRING PROBLEMS FACING THE LOWER FEDERAL COURTS IN THE CONSTRUCTION AND ADMINISTRATION OF THE BANKRUPTCY CODE.

The Fourth Circuit's adoption of the opinion of the District Court affects important statutory and policy considerations inherent and recurring in the enforcement of the Bankruptcy Code. Litigants and the lower courts need the assistance of this Court in resolving fundamental questions about the application of the Code and interplay between the Code and applicable state law.

Forty-nine states and The District of Columbia have adopted the Uniform Commercial Code, which states, as adopted in North Carolina, that "a check.... does not operate as an assignment of any funds in the hands of the drawee available for its payment...." N.C.G.S. 25A-3-409. The Bankruptcy Code expressly states that "the rights and powers of a trustee under sections 544, 545, and 549 of this title are subject to any generally applicable law...." 11 U.S.C. 546(b) (Emphasis added). Legislative history of the Code defines "generally applicable law" as provisions of law that apply in bankruptcy cases and outside of bankruptcy cases, expressly incorporating by reference the Uniform Commercial Code and applicable state law. Senate Report No. 95-989, 95th Cong., 2d Sess. 86-87 (1978).

Commentators have accepted the Code as extending the ruling of Bank of Marin in cases under 11 U.S.C. Section 549.

> ....[T]he typical transferee of personalty, e.g., the payee of a check as in Bank of Marin v. England, supra, will not be protected under section 549. This is true with respect to the vulnerability of all transferees of personalty under section 549 and reflects a harsh line drawn by the Code between transferees of real and personal property. The only remedy of a transferee of personal property in the vast majority of cases will be a general unsecured claim against the estate under section 502(h). Section 550(b) protects only subsequent good faith transferees, and in most instances a transferee of property from an agent, bailee, or bank of the debtor will be an initial transferee within section 550(a)(1). Thus, the net effect of section 542(e) and 549(a)(2)(A) is to protect only the transferor who, in good faith and without knowledge of the commencement of the case, transfers property of the estate or pays a debt on behalf of the debtor after the commencement of the case. (Emphasis added).

4 Collier on Bankruptcy, para 549.03 (15th Ed. 1979).

Consistent with the decision of the Bankruptcy Court in this case, federal courts have generally held that concepts recognized in Bank of Marin and applicable state law control the disposition of cases under 11 U.S.C. Section 549. See In Re Isis Foods, Inc., 37 B.R. 334, 336 (W.D. Mo. 1984); In Re Wilson, 56 B.R. 74, 76 (Bkrtcy. E. Tenn. 1985); In Re Bridges Enterprises, Inc., 44 B.R. 979, 982 (Bkrtcy. S. D. Ohio 1984); In Re Sims Office Supply, Inc., 94 B.R. 744, 747 (Bkrtcy. M.D. Fla. 1988); In Re W&T Enterprises, Inc., 84 B.R. 838, 839 (Bkrtcy. M.D. Fla. 1988); In Re By-Rite Distributing, Inc., 89

B.R. 906, 908 (D. Utah 1988); Matter of Her Majesties Stout Shop, Inc., 65 B.R. 145, 147 (Bkrtcy. M.D. Fla. 1986); In Re Hoffman, 51 B.R. 42, 46 (Bkrtcy. W.D. Ark. 1985).

The bankruptcy transaction at issue presents a common, recurring issue confronting bankruptcy trustees and lower federal courts. The decision below complicates and confuses the administration of bankruptcy cases in the lower courts. The portion of the estate of the debtor represented by bank deposits is not and cannot now be fixed at the commencement of the case, as contemplated under 11 U.S.C. 541(a)(1)[1] and accepted by a majority of the lower federal court, as set forth above, and commentators:

> Deposits in a bank to the credit of a debtor become the property of the estate under Section 541(a)(1). The bank deposit is a chose in action evidencing the debt owed by the bank to the debtor.

4 Collier on Bankruptcy, para 541.11 (15th Ed. 1979).

The treatment of bank deposits as property of the estate was established under Section 70(a) of the Bankruptcy Act, see Bank of Marin v. England, supra, and Section 541(a)(1) of the Code was drafted with intent to include "all kinds of property, including tangible or intangible property, causes of action..., and all other forms of property currently specified in Section 70(a) of

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1 11 U.S.C. 541. Property of the estate.

(a) The commencement of the case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all the following property, wherever created or by whomever held:

(1) Except as provided in subsections (b) and (1)(c)(2) of this section, all legal or equitable interests of the debtor in the property at the commencement of the case. (Emphasis added).

the Bankruptcy Act." Senate Report No. 95-989, 95th Cong., 2d Sess. 82 (1978). (Emphasis added).

The decision below abrogates the clear line intended to be drawn by Section 70 of the Act and Sections 541(a) and 549 of the Code, and, as Justice Harlan observed with respect to the uncertainty regarding the debtor's estate prior to the 1938 enactment of 70(d), is "conducive to confusion and uncertainty, with potentialities for argument, 'bluffing,' litigation, expense and delay." Bank of Marin v. England, 385 U.S., at 106.

The practical effect of the decision below is to leave the bankruptcy court and trustee uncertain of and unable to determine the debtor's estate until checks tendered prepetition are presented postpetition. Prepetition-dated checks presented after the drawee bank's 11 U.S.C. 542 turnover to the trustee of funds on deposit would present additional administrative problems and litigation for the bankruptcy courts. Indeed, the decision below conflicts directly with the provisions of 11 U.S.C. 542[2]

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2 11 U.S.C. 542 provides in pertinent part as follows:

Section 542. Turnover of property of the estate:

(a) Except as provided in subsection (c) or (d) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall deliver to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

(b) Except as provided in subsection (c) or (d) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor. (Emphasis added).

The decision below creates a rule requiring the trustee to honor postpetition those checks issued and delivered prepetition, unless otherwise avoidable. Given this construction of the Code, how does a bankruptcy court respond to claims of prepetition check payees if the underlying account has been overdrawn, frozen, closed, or made subject to the Code set-off rights of the drawee bank (11 U.S.C. Section 553). These questions are not answered under Bankruptcy Code and no such class of special administrative or priority claims are provided for under the Bankruptcy Code. In an effort to fashion equitable relief for a single creditor, the decision below opened the proverbial can of worms for the bankruptcy courts. Section 549 of the bankruptcy Code, with its specific, limited exceptions to the trustee's postpetition avoidance powers, was intended and should be interpreted to foreclose the uncertainty created by the decision below.

Finally, and perhaps most significantly, the principal objective of the Bankruptcy Code, ratable distribution of the debtor's assets among creditors, is defeated by the Fourth Circuit Court of Appeals' construction of Section 549. The general unsecured creditor favored with a prepetition-dated check recovers his or her entire claim against the debtor's estate. Regardless of whether this result, a preferential transfer vis a vis other general unsecured creditors, is fortuitous or intended in a particular bankruptcy case, it nevertheless undermines the uniform administration of the Bankruptcy Code.

The confusion which will now surround this most fundamental application of the Bankruptcy Code justifies a re-examination of the question presented in the exercise of the Court's supervisory powers.

CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Fourth Circuit.

Respectfully submitted,

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July 21, 1989

No. _____

IN THE SUPREME COURT OF THE UNITED STATES

October Term 1989

John A. Northen, Trustee in Bankruptcy
for Gordon Foods, Inc.
Petitioner

v.

Quinn Wholesale, Inc.
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

APPENDIX

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UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 88-1336

QUINN WHOLESALE, INC.

Plaintiff - Appellee

versus

JOHN A. NORTHEN, Trustee in
Bankruptcy for Gordon Foods, Inc.

Defendant - Appellant

Appeal from the United States District Court for the Middle District of North Carolina, at Greensboro. Frank W. Bullock, Jr., District Judge. (CA-88-302)

Argued: March 9, 1989 Decided: April 26, 1989

Before HALL and WILKINSON, Circuit Judges, and DOUMAR, United States District Judge for the Eastern District of Virginia, sitting by designation.

John A. Northen (Charles T.L. Anderson on brief) for Appellant. Michael Edmond Weddington (Amos U. Priester, IV on brief) for Appellee.

HALL, Circuit Judge:

Appellant is the trustee in the bankruptcy filed by Gordon Foods, Inc. ("Gordon"), a North Carolina corporation which was engaged in a retail grocery business. The bankruptcy court granted summary judgment to the trustee and denied the cross-motion for summary judgment motion by Quinn Wholesale, Inc. ("Quinn"). On appeal to the district court, the bankruptcy court's order was reversed and the case was remanded for entry of judgment in favor of Quinn. It is from this order that the trustee appeals. We affirm.

The facts of this case are undisputed. Quinn, a grocery wholesaler, delivered inventory to Gordon on a weekly basis; at the time of each delivery, Gordon would pay by check for the previous week's delivery. On December 4, 1986, Quinn delivered its inventory and Gordon tendered a check in the amount of $72,444.62 for the previous delivery. The following day, Gordon filed its petition in the bankruptcy court. On December 9, 1986, Gordon's check was accepted and paid by its bank.

The trustee instituted an adversary proceeding against Quinn to recover the amount of the check. The trustee claimed that the payment constituted a post-petition transfer which was subject to the trustee's avoidance powers under 11 U.S.C. Section 549 (a)(1). The only question presented is whether the transfer of the $72,444.62 from Gordon to Quinn occurred, for the purposes of the avoidance provisions, on the pre-petition date of delivery of the check or on the post-petition date of payment of the check by Gordon's bank. Relying primarily on a recent opinion by this Court, as well as on a case directly on point from the Ninth Circuit, the district court held that the transfer was effected when the check was delivered to the creditor Quinn and, therefore, that such transfer was not subject to avoidance as a

post-petition transfer. In re Continental Commodities, Inc., 841 F.2d 527 (4th Cir. 1988) (date of delivery of check dispositive for transfers pursuant to 11 U.S.C. Section 547(c)); In re Trois Etoiles, Inc., 16 B.C.D. 698 (B.A.P. 9th Cir. 1987). We agree.

We affirm for the reasons set forth by the district court in its memorandum opinion. Quinn Wholesale, Inc. v. John A. Northen, Trustee in Bankruptcy for Gordon Foods, Inc., C/A No. C-88-302-G (M.D. N.C. Aug. 23, 1988).

AFFIRMED

JUDGMENT
UNITED STATES COURT OF APPEALS
for the
Fourth Circuit

FILED
APR 26,1989
US Court of Appeals
Fourth Circuit

No. 88-1336

QUINN WHOLESALE, INC.
Plaintiff - Appellee

v.

JOHN A. NORTHEN,
Trustee in Bankruptcy for Gordon Foods, Inc.
Defendant - Appellant

APPEAL FROM the United States District Court for the Middle District of North Carolina.

THIS CAUSE came on to be heard on the record from the United States District Court for the Middle District of North Carolina and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby affirmed.

John M. Greacen
Clerk

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

QUINN WHOLESALE, INC., Plaintiff/Appellant,	)	
v.	)	CIVIL NO. C-88-302-G
	)	(B-86-02467C-7)
	)	
JOHN A. NORTHEN, Trustee in Bankruptcy for Gordon Foods, Inc.,	)	
	)	
Defendant/Appellee	)	

ORDER

BULLOCK, District Judge

For the reasons set forth in the memorandum opinion filed contemporaneously herewith,

IT IS HEREBY ORDERED THAT the order and judgment of the United States Bankruptcy Court for the Middle District of North Carolina allowing the Trustee in Bankruptcy for Gordon Foods, Inc., to recover from Quinn Wholesale, Inc., pursuant to 11 U.S.C. section 549, the sum of $72,444.62 plus interest; and denying Quinn Wholesale, Inc.'s motion for summary judgment is **REVERSED** and the case is **REMANDED** to the United States Bankruptcy Court for the Middle District of North Carolina for entry of judgment for Quinn Wholesale, Inc.

Frank W. Bullock, Jr.
United States District Judge

August 23, 1988

IN THE UNITED STATES DISTRICT COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

QUINN WHOLESALE, INC., Plaintiff/Appellant,	)	
v.	)	CIVIL NO. C-88-302-G
	)	(B-86-02467C-7)
	)	
JOHN A. NORTHEN, Trustee in Bankruptcy for Gordon Foods, Inc.,	)	
Defendant/Appellee	)	

MEMORANDUM OPINION

BULLOCK, District Judge

Quinn Wholesale, Inc. ("Quinn") takes this appeal from a judgment of the bankruptcy court requiring Quinn to return a payment received from Gordon Foods, Inc. ("Debtor") to the Trustee in Bankruptcy for Gordon Foods. The bankruptcy court found the payment to Quinn to be a post-petition transfer for a pre-petition debt, avoidable by the Trustee under 11 U.S.C. section 549. For the reasons discussed below, the court finds that the transfer was made before the bankruptcy petition was filed, and therefore reverses the bankruptcy court's decision.

Statement of the Case

Debtor owned and operated grocery stores under the retail name "Piggly Wiggly" in and around Sanford, North Carolina. Quinn supplied grocery inventory to Debtor on a weekly basis. On December 4, 1986, Quinn delivered

an order of inventory to Debtor and at the same time received a check in the amount of $72,444.62 payable to Quinn Wholesale, Inc., and drawn on the Debtor's account with Branch Banking & Trust Co. That amount represented the cost of the previous week's shipment. Branch Banking & Trust honored the check on December 9, 1986.

On December 5, 1986, before the check had been honored, Debtor filed a voluntary petition in bankruptcy under Chapter 11 of the Bankruptcy Code of 1978 (the "Code"). On March 9, 1987, Debtor's bankruptcy petition was converted from a Chapter 11 reorganization to a Chapter 7 liquidation and appellee John Northen was appointed as Trustee in Bankruptcy for Gordon Foods, Inc. Northen then brought this action in bankruptcy court seeking to set aside the payment to Quinn as an unauthorized post-petition payment of a pre-petition debt, which is avoidable under 11 U.S.C. section 549. Quinn argued unsuccessfully to the bankruptcy court that the transfer occurred at the time Debtor tendered the check to Quinn, rather than when the bank honored it. Therefore, the transfer was pre-petition, and Section 549 does not apply.[1] The bankruptcy court disagreed, saying

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1 11 U.S.C. Section 549 (Supp.1988) provides in pertinent part:

(a) Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate – (1) that occurs after the commencement of the case; and (2)... (B) that is not authorized under this title or by the court.

(b) In an involuntary case, a transfer made after the commencement of such case but before the order for relief to the extent any value, including services, but not including satisfaction or securing of a debt that arose before the commencement of the case, is given after the commencement of the case in exchange for such transfer, notwithstanding any notice or knowledge of the case that the

(Footnote continued on Page 8a)

that the weight of authority supported a finding that a payment by check is not considered a transfer until the check is honored. Since the check was honored four days after Debtor filed its bankruptcy petition, the payment was an avoidable post-petition transfer. Thus the sole issue on appeal is the legal question of when a transfer is deemed to occur under the Bankruptcy Code for payments made by check.

DISCUSSION

This court has jurisdiction to hear appeals from final orders of the bankruptcy court under 28 U.S.C. section 158. Although the bankruptcy court's factual findings should not be disturbed unless clearly erroneous, Bankr. R. 8013, Willemain v. Kivitz, 764 F.2d 1019, 1022 (4th Cir. 1985), its legal conclusions are subject to de novo review. In the Matter of Bufkin Bros., Inc., 757 F.2d 1573, 1577-78 (5th Cir. 1985); see also Caswell v. Lang, 757 F.2d 608, 609 (4th Cir. 1985).

....(Footnote continued)

(c) The trustee may not avoid under subsection (a) of this section a transfer of real property to a good faith purchaser without knowledge of the commencement of th case and for present fair equivalent value unless a copy or notice of the petition was filed, where a transfer of such real property may be recorded to perfect such transfer, before such transfer is so transferee has perfected that a bona fide purchaser of such property, against whom applicable law permits such transfer to be perfected, could not acquire an interest that is superior to the interest of such good faith purchaser. A good faith purchaser without knowledge of the commencement of the case and for less than present fair equivalent value has a lien on the property transferred to the extent of any present value given, unless a copy or notice of the petition was so filed before such transfer was so perfected.

11 U.S.C. Section 101(50) (Supp. 1988) defines a "transfer" very broadly as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property." This language does not speak directly to whether the interest represented by a check is sufficient to render delivery of a check a "transfer" under the Code.

The bankruptcy court followed decisions of other courts and looked to state law to determine the interests involved. As had the courts in both Matter of Isis Foods, Inc., 37 Bankr. 334, 336 (W.D. Mo. 1984), and Matter of Bridges Enterprises, Inc., 44 Bankr. 979, 982 (Bankr. S.D. Ohio 1984), the bankruptcy court relied on the language of Uniform Commercial Code Section 3-409, as adopted by state statute. North Carolina General Statute Section 25-3-409 states that "[a] check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it." The bankruptcy court found that this statutory embodiment of common law negotiable instruments law is applicable to the bankruptcy context. The bankruptcy court also cited two older North Carolina cases, Perry v. Bank of Smithfield, 131 N.C. 117, 42 S.E. 551 (1902), and In re Will of Winborne, 231 N.C. 463, 57 S.E.2d 795 (1958), as further support for the position that title to funds on deposit does not pass to the payee until the check is honored. The bankruptcy court concluded that since title does not pass upon delivery of the check, such delivery is not "a parting with property or with an interest in property," i.e., a transfer under the Bankruptcy Code.

Quinn argued below and argues again on appeal that reliance on state law is misplaced. The Supreme Court has stated that "[w]hat constitutes a transfer ... is necessarily a federal question, since it arises under the federal statute intended to have uniform application throughout

the United States." McKenzie v. Irving Trust Co., 323 U.S. 365, 369-70 (1945). In making the argument for uniformity and for finding a transfer at time of delivery of the check Quinn relies heavily on the Ninth Circuit Bankruptcy Appellate Panel's decision in In re Trois Etoiles, Inc., 78 Bankr. 237 (Bankr. 9th Cir. 1987). In In re Trois Etoiles, the Panel expressly acknowledged and rejected prior decisions relying on state law, including Matter of Isis Foods and Matter of Bridges Enterprises. 78 Bankr. at 238. The Panel instead looked to Ninth Circuit precedent regarding when transfers by check occur under the Code, and also considered commercial reality in concluding that a debtor's tendering of a check to the creditor before filing the bankruptcy petition constitutes a pre-petition transfer, despite the fact that the check was not honored until after the petition had been filed.

The bankruptcy court countered Quinn's arguments in two ways, which the Trustee has adopted in his response to this appeal. First, the bankruptcy court noted that other provisions of the Bankruptcy Code refer to state law for clarification of parties' rights, see, e.g., 11 U.S.C. Section 522 (subsection [b][1] allows exemptions to be defined by state law), and also reasoned that the desired uniformity can be achieved through reference to the Uniform Commercial Code. Reference to state law may be helpful in determining rights under the Bankruptcy Code, and in fact in McKenzie the Court determined the comparative rights of the payee versus lien creditors under state law. 323 U.S. at 370. However, the Court was applying a provision under the Bankruptcy Act of 1898 which was comparable to Section

547(e)(1)(B) of the Code, which defines the time of transfer in terms of when the payee's rights became superior to the claim of any possible contract creditor who obtains a judicial lien.[2] The Fourth Circuit has ruled that the Section 547(e)(1)(B) standard applies only where security interests are involved. In re Continental Commodities, Inc., 841 F.2d 527, 530 (4th Cir. 1988).

In contrast, the general definition of "transfer" in Section 101(50) of the Code applies to all transactions and is sufficiently broad that it need not be interpreted as making the timing of a transfer dependent on the respective rights of the payee against other creditors. Therefore, it does not require a reference to such rights as defined under state law.

Moreover, although adoption of the UCC by all but one state means that the statutory language in those states is comparable, a fair reading of UCC Section 3-409 would not compel a finding that passage of a check from debtor to creditor is not a transfer under 11 U.S.C. Section 101(50). An at least equally reasonable interpretation of the two provisions is that regardless of when title to the funds vests the payee, delivery of the signed check is a mode of parting with the debtor's interest in those funds. The check is an unconditional order to pay the funds, UCC Section 3-104(1)(b) and 2(a), (b), so that at the time of delivery the debtor has essentially completed his affirmative acts necessary to make the transfer.

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2 11 U.S.C. Section 544(a)(1) gives the Trustee in Bankruptcy the status of a prospective judicial lienholder. The Fourth Circuit's decision in In re Continential Commodities suggests that this is irrelevant to the timing of the transfer in this case.

The possible intervening events mentioned by the trustee and the bankruptcy court, such as a stop-payment order, are subsequent affirmative acts needed to negate that transfer, and in the absence of them the debtor's relinquishment of funds is complete.[3]

The bankruptcy court also found for the Trustee because it was unpersuaded by the Ninth Circuit Bankruptcy Appellate Panel's decision in In re Trois Etoiles. The bankruptcy court rejected the Panel's position as erroneously based on analogies with the "contemporaneous exchange" and "ordinary course of business" exceptions to the preference rules. 11 U.S.C. Section 547(c). Numerous courts, including recently the Fourth Circuit, have found that for the purposes of the Section 547(c) exceptions a transfer should be considered made upon delivery rather than when the check is honored. See In re Continental Commodities, 841 F.2d at 530; O'Neill v. Nestle Libbys P.R., Inc., 729 F.2d 35, 37 (1st Cir. 1984); Bernstein v. RJL Leasing (In re White River Corp.), 799 F.2d 631, 633 (10th Cir. 1986). Those decisions were based in part on the legislative history of the provisions, which contains explicit statements about the timing of transfers, see 124 Cong. Rec. S17414 (daily ed. Oct. 6, 1978) (statement of Senator DeConcini) ("Payment is considered to be made when the check is delivered for purposes of Sections 547[1] and [2]."), cited in O'Neill, 729 F.2d at 37, but the courts also considered policy justifications and commercial reality. See In re Continental Commodities, 841 F.2d at 530; O'Neill, 729 F.2d at 37; In re White River, 799 F.2d at 633-34.

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3 Even if the check represented payment conditioned on nonoccurrence of an intervening event, the court notes that Section 101(50) includes absolute or conditional modes of parting with property.

The bankruptcy court found analogies to this body of law inapposite because the more general exceptions to Section 547 should not be grafted onto the narrow, limited exceptions already included in Section 549.[4] This argument tends to put the cart before the horse. Whether Quinn must rely on the exceptions to Section 549 rather than those under Section 547(c) depends on whether the transfer occurred before or after the petition was filed, the very question at issue. If the transfer occurred at delivery, then neither Section 549(a) nor the exceptions thereto will apply; rather the payment would be a pre-petition transfer within ninety days of filing and Quinn would presumably seek protection under the Section 547(c)(2) ordinary course of business exception to the preference rule. Therefore, for the purpose of deciding when the transfer occurred, reference to judicial treatment under the Code as a whole is appropriate.[5]

In short, the statutory language and applicable precedent do not require rejection of the analysis in In re Trois Etoiles in favor of the Matter of Isis Foods and Matter of Bridges Enterprises decisions. Uniformity is not advanced by reference to state law and the UCC and, even if applicable, neither compels a finding that the transfer occurs when the check is honored.

Policy considerations can support either position, as the valid arguments of the bankruptcy court and the parties show. However, upon consideration of the equities and commercial realities the court finds that the better interpretation of the rule, to be uniformly applied, favors treatment of transfers by check as made at the time of delivery.

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4 See n.1, supra.

5 Interestingly, In re Midwest Boiler & Erectors, Inc., 54 Bankr. 793 (Bankr. E.D. Mo. 1985), relied on by the bankruptcy court and the Trustee, involved a challenge to Section 547.

The court acknowledges the Trustee's contention that one of the objectives underlying the Code is equal treatment of creditors within a class. The Trustee argues that allowing Quinn to retain the check proceeds conflicts with this objective because it treats Quinn better than other unsecured creditors, who are unlikely to recover full payment on their claims. Also, had Quinn been unable to cash the check after the petition was filed, because the account was frozen or had insufficient funds, then Quinn would have been relegated to making a claim on either the check or the underlying transaction as an unsecured creditor. This demonstrates the contingent nature of the payee's interest, and suggests that but for a fortuity Quinn would unquestionably be just another unsecured creditor.

The Trustee's valid and persuasive arguments are counterbalanced by more persuasive policy and equitable considerations. First, the interests of the estate and the policies underlying the Code are not substantially affected by construing "transfer" broadly, in keeping with the statutory definition. The effect of treating transfers by check as made upon delivery will simply be to characterize more such transfers as pre-petition.

The Trustee will still be able to avoid those which were not in the ordinary course of business or were not part of contemporaneous exchange, but will do so under the preference statute.[6] The trade creditors dealing with the debtor in the ordinary course of business (and the

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6 The court recognizes that some payments not in the ordinary course which are delivered more than ninety days before filing but honored within ninety days will not be included in the estate. The court does not believe that choosing this description of the estate will hinder the objectives underlying the preference rules because the debtor will have at most limited ability to plan its filing more than ninety days in advance, and to disipate its assets accordingly.

person who exchanges value for value) will continue to be protected, as intended by Congress. See O'Neill, 729 F.2d at 37 (quoting S. Rep. No. 989, 95th Cong. 2d Sess. 88, reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5874).

Second, treating the debtor's checks as transfers comports with the commercial reality, and is consistent with the expectations of those trade creditors, like Quinn, whose willingness to continue doing business provides the debtor an opportunity to avoid bankruptcy. In re Continental Commodities, 841 F.2d at 530 (citing O'Neill, 729 F.2d at 37-38 [checks are normally considered present payments between parties, so the delivery should supply the time of transfer]; In re White River, 799 F.2d at 634 [in commercial world receipt of check, not date it clears, is customarily treated as the date of payment] [quoting Young Supply Co. v. McLouth Steel Corp., 55 Bankr. 356, 357 (E.D. Mich. 1985)]).

The Fourth Circuit implied several years ago that courts should not attempt to alleviate the harsh results the Code sometimes dictates against creditors. See Lake v. New York Life Ins. Co., 218 F.2d 394, 399 (4th Cir.), cert. denied, 349 U.S. 917 (1955). However, this does not mean that where the language of the Code is susceptible to two reasonable interpretations the court must choose the one which operates more harshly.

The parties agreed in the bankruptcy court and on appeal that there are no disputed issues as to any material fact. Since the transfer was pre-petition, the Trustee may not avoid the transfer pursuant to 11 U.S.C. Section 549. Accordingly, the order and judgment of the

bankruptcy court requiring Quinn Wholesale, Inc., to return $72,444.62 plus interest and denying Quinn's motion for summary judgment is reversed.[7]

An order in accordance with this memorandum opinion shall be entered contemporaneously herewith.

Frank W. Bullock, Jr.
United States District Judge

August 23, 1988

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7 Because the court finds that the transfer was made before the petition was filed, Quinn's contention that the transfer was authorized under 11 U.S.C. Section 1107 and 1108 need not be addressed.

UNITED STATES BANKRUPTCY COURT
FOR THE MIDDLE DISTRICT OF NORTH CAROLINA
Case No. B-86-02467C-11

IN RE:	)	
	)	
Gordon Foods, Inc.	)	
Debtor	)	
	)	Adversary Proceeding
	)	No. A-87-0097
	)	
John A. Northen, Trustee in Bankruptcy for Gordon Foods, Inc.	)	
Plaintiff	)	
	)	ORDER AND
vs.	)	JUDGMENT
Quinn Wholesale, Inc.	)	
Defendant	)	

UPON NOTICE to all interested parties and Hearing at 2:00 o'clock p.m. in the Third Floor Courtroom, Kress Building, 103 W. Main Street, Durham, North Carolina, upon Motions for Summary Judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure and Bankruptcy Rule 7056, and the Court finding that there are no material issues of fact and that the Plaintiff is entitled to Judgment as a matter of law, it is hereby

ORDERED, ADJUDGED AND DECREED that the Plaintiff have and recover of the Defendant the sum of $72,444.62, together with interest thereon at the rate of 8.0% per annum from and after December 9, 1986

until paid, together with the costs of this action; and it is further

ORDERED that Defendant's Motion for Summary Judgment is hereby denied; and it is further

PROVIDED that the Court reserves the right to file a Memorandum Opinion in support of this Order and Decree in the event of Appeal by either party hereto.

This the 7 day of March, 1988.,

Jerry G. Tart

Jerry G. Tart
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT FOR
THE MIDDLE DISTRICT OF NORTH CAROLINA

In Re:	)	
	)	
GORDON FOODS, INC.	)	
	)	B-86-02467-C-7
Debtor.	)	
	)	
	)	
JOHN A. NORTHEN, Trustee in Bankruptcy for Gordon Foods, Inc.,	)	
Plaintiff,	)	
	)	Adversary Proceeding
v.	)	No. A-87-0097
	)	
QUINN WHOLESALE, INC.	)	
	)	
Defendant	)	

MEMORANDUM OPINION[1]

THIS MATTER came on for consideration upon the Trustee's complaint pursuant to 11 U.S.C. section 549 to set aside an alleged postpetition transfer of $72,444.62 from the debtor to the defendant, Quinn Wholesale. The Court heard arguments of counsel on the motion for

1 This memorandum opinion was written pursuant to the previously filed order and judgment in this case. That order dated March 7, 1988, reserved the right for the court to file a Memorandum Opinion in support thereof in the event of an appeal.

summary judgment filed by the defendant, Quinn Wholesale, and a cross motion for summary judgment filed by the plaintiff Trustee, John A. Northen. Both the plaintiff and the defendant submit that there is no dispute as to any material fact in this action, and that it is therefore ripe for summary disposition as a matter of law pursuant to Rule 7056 of the Bankruptcy Rules.

At the hearing in the case, arguments of counsel were heard and the Court having carefully considered the briefs of counsel, the stipulation of facts, the official court file, the arguments of counsel, and based upon the following statement of facts, does herewith make the following conclusions of law.

STATEMENT OF THE FACTS

The debtor in this bankruptcy case operated retail grocery business in Sanford and Lumberton, North Carolina. The defendant, Quinn Wholesale, engaged in the business of wholesale supply of grocery and supermarket inventories, and supplied the debtor with inventory on a weekly basis receiving payment from the debtor each week for the prior week's delivery.

On December 4, 1986, the defendant, Quinn Wholesale, delivered inventory to the debtor and the debtor tendered to Quinn Wholesale a check payable to Quinn Wholesale in the amount of $72,444.64, which check represented payment for inventory delivered by Quinn Wholesale the week prior to December 4, 1986.

The following day, Friday, December 5, 1986, the debtor filed a voluntary petition under Chapter 11 of the Bankruptcy Code in the United States Bankruptcy Court for the Middle District of North Carolina.

On December 9, 1986, the debtor's check made payable to Quinn Wholesale for $72,444.64 was presented to debtor's bank, accepted and paid.

The debtor's bankruptcy case was converted to a case under Chapter 7 of the Bankruptcy Code on March 9, 1987, and the plaintiff, John A. Northen, was appointed Trustee in bankruptcy for the debtor. The plaintiff Trustee instituted this action on December 3, 1987, alleging that the defendant, Quinn Wholesale, received a check from Gordon Foods, Inc., the debtor, which constituted a postpetition payment in satisfaction of a prepetition debt, such transfer being avoidable pursuant to 11 U.S.C. section 549.

ISSUE

The principal issue presented by both the plaintiff and defendant on cross motions for summary judgment is whether a check which was tendered by the debtor to its creditor prepetition, but accepted and paid, or otherwise honored by the debtor's financial institution postpetition, constitutes a transfer of property of the estate of the debtor that may be avoided pursuant to 11 U.S.C. section 549. In other words, the crucial question is whether the transfer occurs, for purposes of 11 U.S.C. section 549, on the date a check is tendered, or on the date the instrument is honored by the payor's financial institution, at which time a withdrawal of funds from the payor's account and transfer of funds to or for the benefit of the payee occurs.

CONCLUSIONS OF LAW

11 U.S.C. section 549(a) provides as follows:

> Except as provided in subsection (b) or (c) of this section, the trustee may avoid a transfer of property of the estate –
>
> (1) made after commencement of the case; and

(2)(A) that is authorized only under section 303(f) or 542(c) of this title; or

(B) that is not authorized under this title or by the court.

The Trustee's power to avoid transfers of property of the estate that are made after the commencement of the case is subject only to the exceptions created by subsections (b) and (c) of section 549 of the Bankruptcy Code. Subsection (b) protects "involuntary gap" transferees whose property is transferred between the date of filing of an involuntary petition and the date the order for relief is entered. Subsection (c) protects the good faith purchaser of real estate who has no knowledge of the commencement of the bankruptcy proceeding. Neither of these exceptions is applicable in the instant case. Therefore, the Court must determine if this transfer was postpetition, and, if so, it must be deemed in violation of applicable bankruptcy law and avoidable by the Trustee under 11 U.S.C. section 549.

The plaintiff Trustee maintains that the transfer occurred when the drawee bank honored the check. The defendant, Quinn Wholesale, suggests the transfer occurred at an earlier date, when Gordon Foods tendered the check in payment on the account. This court must follow the greater weight of authority and find that payment, and hence the transfer, occurred when the drawee bank honored the check.

Under the Bankruptcy Code, a transfer means "every mode direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including a retention of title as a security interest." 11 U.S.C. section 101(50) (Colliers 1988). In order to determine the date of transfer when payment is made by check or draft, the court must look to state law. Matter of Isis Foods, Inc., 37 B.R.

334 (W.D. Mo. 1984); Matter of Bridges Enterprises, Inc., 44 B.R. 979 (Bkrtcy. S.D. Ohio 1984); In Re Wilson, 56 B.R. 74 (Bkrtcy. E.D. Tenn. 1985); In Re Midwest Boilers & Erectors, Inc., 54 B.R. 793 (Bkrtcy. E.D. Mo. 1985) (Section 547 Case citing, Matter of Isis Foods, Inc.). The majority of courts addressing the issue of when a transfer by check occurs under Bankruptcy Code section 549 have all referred to state law to determine when that transfer is complete. These courts have discovered that state law has adopted the guidelines established by the Uniform Commercial Code and the generally accepted law of negotiable instruments. Under the Uniform Commercial Code, which codified the common law principles of negotiable instruments, a check does not vest in the payee any title to or interest in the funds held by the drawee bank. Uniform Commercial Code, section 3-409 (West 1987). The check is only an unconditional promise to pay the payee, and an order to the drawee bank to pay the sum stated to that payee. Therefore, under the law of negotiable instruments and the Uniform Commercial Code the date of transfer is the date of presentment, honor and payment by the drawee bank, and not the date of delivery or tender of the draft. Simply stated, a check does not constitute a transfer of the funds until it is paid, and thus, tender or delivery of a check itself does not constitute a transfer as defined by section 101(50) and applied by section 549(a). Matter of Isis Foods, Inc., 37 B.R. 334 (W.D. Mo. 1984); Matter of Bridges Enterprises, Inc., 44 B.R. 979 (Bkrtcy. S.D. Ohio 1984); In Re Wilson, 56 B.R. 74 (Bkrtcy. E.D. Tenn. 1985); In Re Midwest Boilers & Erectors, Inc., 54 B.R. 793 (Bkrtcy E.D. Mo. 1985).

The rationale for declaring the date of transfer as the date of presentment and honor of the draft can be explained by the well founded law of negotiable instruments. Since a check is not an assignment of funds held

by a drawee bank and does not vest any title or interest in the payee, a number of events between tender of the check and presentment and honor by the drawee bank might occur to interfere with the draft's normal payment. A few examples of what might occur can be found in the Uniform Commercial Code as it is generally applied and are as follows:

1. The death or incompetence of a customer. Once the bank knows or has reason to know of the death or incompetence of a customer the bank may refuse to honor a check drawn on that customer's account. In fact, ten days after the date of death the authority of the bank to pay such checks is revoked. Uniform Commercial Code, section 4-405 (West 1987).

2. Stop payment order from the payor. Since payment by check does not constitute an immediate assignment of funds and the payor retains title to and control over the funds on deposit, the payor may arrest payment at any time before presentment and honor by the bank. Uniform Commercial Code, section 4-403 (West 1987).

3. Garnishment of attachment by a creditor. A creditor can engage legal process to claim an interest in payor's funds. Uniform Commercial Code, section 4-303 (West 1987).

4. Exercise of right to set-off by drawee bank. The relationship between drawee bank and the drawer customer is one of debtor-creditor. The bank is the debtor and the customer is the creditor in reference to any funds on deposit with the drawee bank. Like any debtor, the bank has a right to set-off any amounts due it against the debt owed the customer. Uniform Commercial Code, section 4-303 (West 1987).

The application of the law of negotiable instruments to the question of when a transfer by check is complete serves only to reinforce the court's determination that the date of transfer in this instant case was December 9, 1986. On that date the draft was honored by the bank, and a withdrawal of funds to or for the benefit of the defendant, Quinn Wholesale occurred. December 5, 1986, the date of issuance and delivery of the check, is irrelevant as delivery of the check did not constitute a transfer as defined by Bankruptcy Code Section 101(50) and was certainly not a transfer of property of the estate as defined by Section 549(a).

North Carolina law mandates the conclusion that a transfer by check does not occur until the check is honored by the drawee bank. Under North Carolina law, "a check or other draft does not of itself operate as an assignment of any funds in the hands of the drawee available for its payment, and the drawee is not liable on the instrument until he accepts it." N.C.G.S. 25-3-409 Draft not an assignment. (Michie 1986).

North Carolina's adoption of the Uniform Commercial Code is consistent with other state's adoptions of the Uniform Commercial Code and with the majority position espoused in the federal bankruptcy decisions cited herein. Furthermore, North Carolina case law prior to the adoption of the Uniform Commercial Code by the state established the precedent that a check does not pass title to funds on deposit to the payee until it is honored. Perry v. Bank of Smithfield, 131 N.C. 117, 42 S.E. 537 (1902); In Re Will of Winborne, 231 N.C. 462, 57 S.E.2d 795 (1958). Hence, under state law as applied by this bankruptcy court in the state of North Carolina, the debtor retained title to and control over the funds on deposit at the commencement of this case on December 5, 1986 through December 9, 1986 when the debtor's check was accepted by the drawee bank and the funds

were withdrawn from the debtor's account and transferred to or for the benefit of Quinn Wholesale. The transfer did not occur until December 9, 1986 and, therefore, was postpetition. The plaintiff Trustee, with the powers of a judicial lien creditor, can avoid this transfer in the same manner as a judgment lien creditor could have attached or garnished the funds on deposit at the drawee bank between the date of issuance of the check on December 4, 1986 and the date the check was honored on December 9, 1986.

The defendant argued that payment by check is the equivalent of a cash transaction. In support of this contention, the defendant cites the "ordinary course of business" and "contemporary exchange for a new value" exceptions found in 11 U.S.C. section 547(c). This argument is based on the recent decision of the Bankruptcy Appellate Panel for the 9th Circuit in In re Trois Etoiles, Inc.. This is the only reported decision holding that a transfer by check occurs at the time of tender or delivery of the draft for purposes of section 549 postpetition transfers. In re Trois Etoiles, Inc., 78 B.R. 237 (BAP 9th Cir. 1987). The Bankruptcy Appellate Panel relied on a number of decisions under 11 U.S.C. section 547 and the decisions in the 9th Circuit holding that a check constitutes a "cash" sale. Id. at 239. The court rationalized that a check was a contemporaneous exchange or transfer as long as the draft was honored within a reasonable time after issuance. Id. at 239. This court is not persuaded by the 9th Circuit's comparison of transfers under section 547 to transfers under section 549 of the Bankruptcy Code. The exceptions found in section 547(c) apply to preferential transfers and have no application to transfers attempted to be avoided by the trustee under Section 549. As stated above, section 549 has its own very narrow exceptions to transfer avoidance by the trustee in bankruptcy. Moreover, it is without question that the

check in this case was delivered in payment of an antecedent debt and not for new value.

This court will not follow in the steps of the Bankruptcy Appellate Panel for the 9th Circuit in departing from the clear language of the Bankruptcy Code and established state law precedent. By engaging in "judicial legislation" the 9th Circuit has attempted to remedy what might appear to be a harsh application of section 549 of the Bankruptcy Code. That section is quite clear on its avoidance powers, and any transfer not specifically excepted therein is subject to scrutiny by the trustee. Regardless of the intent of the parties and the seemingly innocence of the transaction, the transfer which operates to deplete the debtor's estate for the benefit of one creditor and to the detriment of all others is avoidable by the trustee. Congress, in enacting this provision, promoted the primary bankruptcy policy of equality of distribution among the creditors of the debtor. For these reasons, this court is not willing to adopt the minority position of the 9th Circuit Bankruptcy Appellate Panel. The better reasoned and more rationally based argument follows the majority decisions cited herein adopting the law of negotiable instruments on when a transfer by check occurs. In the instant case, the transfer occurred on December 9, 1986, and is therefore, a postpetition transfer avoidable and recoverable by the plaintiff Trustee pursuant to 11 U.S.C. sections 549 and 550.

The defendant further argued that it is overly burdensome and contrary to the underline theme of uniformity found in the Bankruptcy Code for Federal Bankruptcy Courts to look to state law in determining the time of transfer. The defendant alleged that this would defeat the purpose of uniformity of Federal Law and result in contrary decisions by the Federal Courts in different states. This court is not persuaded by the defendant's contention. First, uniformity exists because of the wide

adoption of the Uniform Commercial Code. Virtually every jurisdiction in the United States has adopted the Uniform Commercial Code (Forty-nine states and the District of Columbia have adopted the Uniform Commercial Code). Therefore, the court believes that uniformity exists and that reference to state law is proper and within the bounds permitted by the Bankruptcy Code. Second, it is quite common for the Federal Bankruptcy Court to refer to state law in determining debtor-creditor relations under the Bankruptcy Code. An example is found in 11 U.S.C. section 522, which provides federal exemptions and allows a state to "opt out" of the federal exemptions in exchange for the state's own exemption laws. Only the state exemptions remain available to a debtor who resides in a state which has "opted out" of the federal exemptions. In these instances, the Bankruptcy Court must look to state law and the exemptions provided therein in order to dictate the exemption conduct of a debtor filing for federal bankruptcy protection. 11 U.S.C. section 522 (Colliers 1988). Another example is when a Bankruptcy Court determines the existence of property interests of the debtor. In Re Fletcher Woods, Inc., No. C-87-6210G, slip op. at 5-6 (M.D.N.C. 1988) ("in order to determine the existence and nature of the debtor's legal or equitable interest in property, bankruptcy courts refer to state law, but the bankruptcy court must apply state law in a manner consistant [sic] with federal law." citing, Johnson v. First National Bank of Montevido, Minnesota, 719 F. 2d 270 (8th Cir. 1983); cert. denied, 465 U.S. 1012 (1984); In Re North America Coin and Currency, Ltd., 767 F.2d 1573 (9th Cir. 1985). Thus, this court does not find the reference to state law burdensome or against the policies of the Bankruptcy Code.

Finally, the defendant maintained the transfer was authorized by the Bankruptcy Code and hence excepted from the trustee's avoidance powers. 11 U.S.C. section

549(a)(2)(B). Defendant relies on the debtor-in-possession's right to operate its business pursuant to 11 U.S.C. section 1108. This authorization includes the right to incur and pay postpetition debt in the ordinary course of operating the business. This court recognizes a debtor-in-possession's authorization to conduct an ongoing business, however, section 1108 only authorizes postpetition transfers in payment of postpetition debts. As illustrated above and stipulated to by the parties in the facts of this case, the transfer by Gordon Foods, Inc. to Quinn Wholesale, Inc. was payment of a prepetition debt incurred the week prior to December 4, 1986. It resulted in the postpetition transfer in payment of a prepetition debt. These transactions are not allowed by section 1108 and are specifically prohibited by the purpose of the Bankruptcy Code through the trustee's avoidance powers under section 549. The district court in Matter of Isis Foods, Inc., rejected the same argument offered by the defendant in that case noting, "section 549 has its own 'very narrow exceptions.' ... In contrast, section 1108 speaks in broad general terms, and if construed as an exception to section 549, it would promptly devour the rule. Second, this court cannot conclude that authorizing postpetition transfers for prepetition debts is within the scope of the debtor's business."

Therefore, for the reasons set forth in this memorandum opinion, the motion of the defendant for summary judgement is denied and the cross-motion of the plaintiff Trustee is granted with judgement entered for the plaintiff Trustee and against the defendant Quinn Wholesale, Inc. in the amount of $72,444.62, together with interest thereon at the rate of 8.0% per annum from and after December 9, 1986 until paid, together with the costs of this action.

April 18, 1988.

Jerry G. Tart

Jerry G. Tart
U.S. Bankruptcy Judge

Supreme Court, U.S.
FILED
AUG 24 1989
JOSEPH F. SPANIOL, CLERK

NO. 89-128

IN THE

Supreme Court of the United States

October Term 1989

John A. Northen, Trustee in Bankruptcy
for Gordon Foods, Inc.
Petitioner

v.

Quinn Wholesale, Inc.
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF OF RESPONDENT

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QUESTION PRESENTED FOR REVIEW

Under the Bankruptcy Code, 11 U.S.C. §§101(50) and 549, does a payment made by a check constitute a "transfer" as of the time of delivery of the check?

LIST OF PARTIES

The parties to the proceedings below were the petitioner, John A. Northen, trustee in bankruptcy for Gordon Foods, Inc., and the respondent, Quinn Wholesale, Inc.[1]

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[1] Quinn Wholesale, Inc. is a subsidiary of Scrivner, Inc., which in turn is a subsidiary of Haniel Corp.

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SUMMARY OF ARGUMENT FOR DENIAL OF WRIT

The Petitioner's Petition for Writ of Certiorari fails to satisfy the considerations governing review on certiorari set forth in Supreme Court Rule 17.1. There are several reasons why the Petition fails to supply an adequate basis for this Court to exercise its discretion to review the Fourth Circuit decision of which the Petitioner complains.

First, the decision reached by the Court of Appeals is simply and clearly the correct one. A check delivered by a debtor to its creditor prior to the filing of a bankruptcy petition, accepted and paid by the debtor's bank without knowledge of the bankruptcy and in the ordinary course of business after the filing of the petition, does not constitute an avoidable transfer under

11 U.S.C. §549. In reaching their decisions, the District Court and Court of Appeals took into account certain legal and practical considerations which compel the conclusion that the transfer in question is not a post-petition transfer within the meaning of 11 U.S.C. §549.

Second, the decision reached by the Court of Appeals is not inconsistent with this Court's decision in Bank of Marin v. England, 385 U.S. 99 (1966), or other decisions of this Court. The question now before this Court was not addressed in Bank of Marin and the facts now before this Court are clearly distinguishable from those in Bank of Marin. However, even to the extent that Bank of Marin or other decisions of this Court may be applicable, the decision

reached by the Court of Appeals is not in conflict with those decisions.

Finally, rather than raising significant and recurrent problems for the lower federal courts in the construction and administration of the Bankruptcy Code, 11 U.S.C. §101 et seq., the decision of the Court of Appeals will have the opposite effect. To the extent that in the past there has been any confusion among the lower federal courts concerning the issue now before this Court, that confusion was fostered by the fact that no appellate level court had considered the question. Within the last two years, however, two appellate courts have considered the question and both have reached the same conclusion. See Quinn Wholesale, Inc. v. John A. Northen, 873 F.2d 77 (4th Cir. 1989); In re Trois Etoiles, Inc.,

16 B.C.D. 698 (B.A.P. 9th Cir. 1987). As these recent appellate decisions serve to invalidate contrary decisions and provide consistent instruction and guidance to the lower federal courts in their circuits, decisions will become more uniform and all lower federal courts will be given a "bright line" by which the Bankruptcy Code can be construed and administered.

ARGUMENTS

I. **This Court should deny the Petition for a Writ of Certiorari as the Court of Appeals correctly decided the question presented in this case.**

Simply put, this Court should refuse to grant the Petition because the decision reached by the Court of Appeals is the correct decision.

First, the decision is in accord with the majority of the decisions which

have addressed this issue under the avoidance powers of the bankruptcy trustee pursuant to 11 U.S.C. §547. See 4 Collier on Bankruptcy ¶547.16[4] (15th ed. 1979) (citing cases). Thus, the desired result of uniformity of federal decisions has been furthered by the Court of Appeals' decision.

Second, the decision reached by the Court of Appeals comports with commercial reality in that, in modern financial transactions, a check is considered the equivalent of cash. Id. Furthermore, the Bankruptcy Code encourages the use of checks in business transactions and encourages creditors to deal with failing businesses. See, e.g., In re White River Corporation, 799 F.2d 631 (10th Cir. 1986); In re Midwest Boiler & Erectors, Inc., 54 Bankr. 793 (Bankr. E.D. Mo. 1985); In re

Fasano/Harriss Pie Company, 43 Bankr. 871 (Bankr. W.D. Mich. 1984). Viewing the transfer of the property of the debtor to be the date of delivery of a check best implements these two policies and is "in accord with commercial reality." O'Neill v. Nestle Libbys P.R., Inc., 729 F.2d 35, 37 (1st Cir. 1984).

On the other hand, the construction urged by the Petitioner would fail to recognize this "commercial reality" and would require that businesses necessarily curtail the use of checks and, instead, insist that all of their transactions with individuals or entities which are even remotely financially troubled be in cash or on a "cash equivalent basis" for fear that the transfer would later be avoided due to an unlucky or precipitous bankruptcy

filing. Such actions would inevitably lead to a reduction in the amount of credit available to financially troubled businesses and in the number of creditors willing to deal with them. This result could not have been intended by Congress, as one of the stated purposes of the Bankruptcy Code is the rehabilitation and reorganization of failing businesses.

For the reasons set forth above, together with those additional reasons articulated by the District Court in its Memorandum Opinion and by the Court of Appeals in its affirmance of that decision, the Petition should be denied.

II. The decision of the Court of Appeals does not conflict with Bank of Marin v. England or other decisions of this Court.

Petitioner argues that the decision of the Court of Appeals conflicts with

the decision of this Court in Bank of Marin v. England, supra, and other decisions of this Court. To the contrary, the decision of the Court of Appeals is wholly consistent with Bank of Marin and other relevant decisions of this Court.

In the first place, the facts in Bank of Marin are clearly distinguishable from the facts of this case. In Bank of Marin, the sole question presented to the Court was "whether a bank which honored checks of a depositor drawn before its bankruptcy, but presented for payment after it had filed a voluntary petition in bankruptcy, is liable to the trustee for the amount of the checks paid where the bank had no knowledge or notice of the proceeding." 385 U.S. 99, 100. This Court was not asked, and in fact did not rule, on the

question of the third party payee's liability. Conversely, in the case now before this Court, the sole question presented concerns the payee's liability for a check delivered before bankruptcy but presented for payment after the filing of the bankruptcy petition.

The fact that 11 U.S.C. §542(c) has expressly affirmed and codified the Bank of Marin decision,[2] a point on which Petitioner places great emphasis, actually provides persuasive evidence that Bank of Marin did not address the facts before the Court in this case. 11 U.S.C. §542(c) deals with the liability of a payor-transferor, such as the drawee bank in Bank of Marin, but makes no mention at all of the liability of a

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[2] See Senate Report No. 95-989, 95th Cong. 2d Sess. 84 (1978).

payee-transferee, such as Respondent in the instant case. Further evidence that Bank of Marin is not controlling under the facts of this case is found in the authorities cited by Petitioner in support of his contentions. In those cases, not one court relied upon Bank of Marin in making its decision.[3]

Futhermore, even to the extent that Bank of Marin may apply, its holding supports the decision of the Court of Appeals in this case. In Bank of Marin, the Court rejected the respondent's argument that the relevant "transfer" within the meaning of §70d(5) of the Bankruptcy Act (the predecessor of 11

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[3] Bank of Marin is cited in only one of those decisions, and that citation was in reference to the conclusion that 11 U.S.C. 542(c) codified Bank of Marin. In re Hoffman, 51 Bankr. 42 (Bankr. W.D. Ark. 1985).

U.S.C. §549) occurred upon payment by the drawee of the drawer bankrupt's checks after the date of the filing of the bankruptcy petition. 385 U.S. 99, 102-103. While the Court did not expressly state when the transfer would be deemed to have occurred, the only other possible time the transfer could have occurred would have been upon delivery of the check, just as determined by the Court of Appeals in this case. As the Court noted in Bank of Marin, "the force of §70d(5) and subsection 18(f) can be maintained by imposing liability on the payee of the checks where he has received a voidable preference or other voidable transfer . . . ." 385 U.S. at 103 [emphasis added]. The Bank of Marin Court realized that fixing the date of transfer as the date of delivery would

make the relevant transfer occur pre-petition and could leave that transaction open to attack by the bankruptcy trustee as a voidable preference. The same prospect exists for a bankruptcy trustee under the Court of Appeals' decision challenged in this case. Accordingly, Bank of Marin clearly is not controlling and, to the extent it may apply, the decision reached by the Court of Appeals in the case now before this Court is consistent with that decision.

In like vein, the decision of the Court of Appeals does not conflict with this Court's decision that the rights of parties to a bankruptcy proceeding are "created by and defined by state law." Butner v. United States, 440 U.S. 48, 55 (1979). While reference to applicable state law may be helpful with respect to

certain discrete questions arising under the Bankruptcy Code, it must be remembered that those questions are to be determined in the broader context of a uniformly interpreted and applied federal law. As this Court has said, "[w]hat constitutes a transfer . . . is necessarily a federal question, since it arises under a federal statute intended to have uniform application throughout the United States." McKenzie v. Irving Trust Company, 323 U.S. 365, 369-70 (1944). Accordingly, the definition given to the term "transfer" by the Court of Appeals in this case is consistent both with prior decisions of this Court in determining property rights and prior decisions of this Court

in defining terms found in federal statutes.[4]

There is no conflict between the decision of the Court of Appeals and any decision of this Court, including Bank

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[4] State law shows that the applicable "transfer" in this case took place upon the delivery of the check prior to the filing of the bankruptcy petition. Pursuant to applicable North Carolina law and the Uniform Commercial Code as adopted in North Carolina, a check is an unconditional promise to pay funds and upon signing and delivering the check the drawer has completed all of the affirmative acts necessary to make a transfer of money. N.C.Gen.Stat. §25-3-104 (1)(B); Kirk Co. v. Styles, Inc., 261 N.C. 156, 134 S.E.2d 134 (1963). Thus, regardless of when "title" to the funds vests in the payee, delivery of the signed check is an unequivocal mode of parting with the debtor's interest in those funds and, subject only to subsequent affirmative acts necessary to negate that transfer, the debtor's relinquishment of funds is complete. Such a relinquishment of funds fits within the broad definition of "transfer" found in 11 U.S.C. §101 (50).

of Marin v. England, and the Petition should be denied.

III. The decision of the Court of Appeals will assist the lower federal courts in the construction and administration of the Bankruptcy Code.

The Petitioner next contends that the decision of the Court of Appeals will raise "significant and recurring problems" in the lower federal courts in the construction and administration of the Bankruptcy Code. In particular, the Petition appears to identify three specific "problems" that Petitioner contends will arise from the Court of Appeals' decision.

First, Petitioner contends that the decision of the Court of Appeals will confuse the lower courts since that "portion of the estate of the debtor represented by bank deposits is not and

cannot now be fixed at the commencement of the case," and that the "practical effect of the decision below is to leave the bankruptcy court and trustee uncertain of and unable to determine the debtor's estate until checks tendered prepetition are presented post-petition." Petition at 10-11. Contrary to Petitioner's implication, the decision of the Court of Appeals does not erase any "bright line" or create problems that do not already exist. For example, even if on occasion the trustee must wait until a check tendered prepetition has been presented and honored postpetition before knowing the exact amount of "good funds" available to him, the trustee can determine that amount upon a simple review of the debtor's books and records. Furthermore, even if the position

advanced by Petitioner was followed, the trustee would still be uncertain of and unable to determine the debtor's estate until the occurrence or non-occurrence of other affirmative events, such as a bank exercising its right of set-off against those funds. Thus, the decision of the Court of Appeals does not create any additional problems of administration that are not already inherent and extant in the bankruptcy system.

Next, Petitioner argues that the decision of the Court of Appeals will only serve to confuse the lower courts as the majority of lower courts which have considered this question under 11 U.S.C. §549 have reached a contrary conclusion. In truth, the Court of Appeals' decision will have the opposite effect. With this decision by the Court

of Appeals and with the decision of the Ninth Circuit Bankruptcy Appellate Panel in In re Trois Etoiles, Inc., 16 B.C.D. 698 (B.A.P. 9th Cir. 1987), the only two appellate level courts to consider this question in the context of 11 U.S.C. §549 have reached the same conclusion. Furthermore, the majority of all decisions, including all of the appellate courts which have dealt with this issue under 11 U.S.C. §547(c) have agreed that the pertinent transfer is made upon delivery of the check if the check is eventually honored within a reasonable time. See 4 Collier on Bankruptcy ¶547.16[4] (15th ed. 1979) (citing cases). Instead of causing confusion, the decision below, the Ninth Circuit Bankruptcy Appellate Panel's decision in In re Trois Etoiles, supra, and the number of cases reaching the

same result under other sections of the Bankruptcy Code will aid in the avoidance of confusion in this area as recent appellate court decisions serve to invalidate contrary decisions of lower courts in their circuits.

Finally, Petitioner contends that one of the principal objectives of the Bankruptcy Code -- ratable distribution of the debtor's assets among creditors -- is defeated by the Court of Appeals' decision since a creditor receiving a pre-petition check honored post-petition will receive his or her entire claim in full. Quite the contrary, the decision of the Court of Appeals does not favor these creditors: rather, the decision of the Court of Appeals recognizes commercial reality and treats the payment by check as the "cash" transactio.. that all concerned intend it

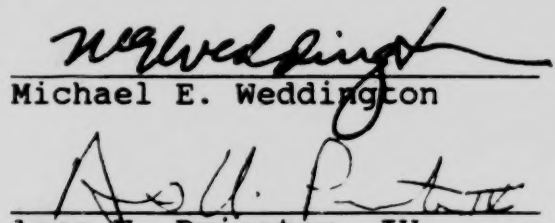
to be. Far from defeating the purposes of the Bankruptcy Code, this "cash transaction" eliminates the check payee as a creditor of the bankruptcy estate, although the transaction remains open to attack by the bankruptcy trustee pursuant to his other avoidance powers (e.g., the preference provisions of 11 U.S.C. §547). Instead of being favored or singled out for a special status, a creditor receiving a check prior to the filing of the bankruptcy petition which is honored after the filing is treated exactly like a creditor which demanded a cash payment on delivery prior to the filing of the bankruptcy petition. The laudatory objectives of the Bankruptcy Code in seeking to obtain ratable distribution of assets among creditors simply is not adversely affected by the decision of the Court of Appeals.

It is therefore clear that the decision of the Court of Appeals will not cause problems for the lower federal courts in the construction and administration of the Bankruptcy Code, and, in fact will assist those courts in that endeavor.

CONCLUSION

For the reasons set forth above, and for such other reasons as this Court should find persuasive, Respondent contends that a writ of certiorari should not be issued to review the judgment and opinion of the Fourth Circuit Court of Appeals in this case.

Respectfully submitted this 23rd day of August, 1989.



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No. 89-128

IN THE SUPREME COURT OF THE UNITED STATES
October Term 1989

John A. Northen, Trustee in Bankruptcy
for Gordon Foods, Inc.
Petitioner

v.

Quinn Wholesale, Inc.
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR
THE FOURTH CIRCUIT

AFFIDAVIT OF SERVICE AND MAILING
RESPONSE TO PETITION FOR CERTIORARI

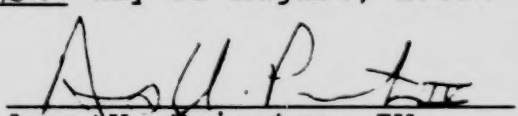
I, Amos U. Priester, IV, being duly sworn, deposes and says:

I am a member of the Bar of the Supreme Court of the United States.

I hereby certify that on August 23, 1989 an envelope was deposited in the United States Mail addressed to the Clerk of Supreme Court of the United States, first-class, postage prepaid, containing 40 copies of the Response to Petition for Writ of Certiorari in the above-entitled case.

I further certify that on August 23, 1989 an envelope was deposited in the United States mail addressed to John A. Northen, Esq., Post Office Box 2208, Chapel Hill, North Carolina 27515-2208, counsel for Petitioner herein, by first class mail, postage prepaid, containing 3 copies of the Response to Petition for Writ of Certiorari in the above-entitled case. I further certify that all parties required to be served have been served.

This the 23rd day of August, 1989.



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